

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

June 28, 1985

Digital Equipment Corporation
100 Nagog Park
Acton, MA 01720

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Edward M. Griffith
Phillips, Lytle, Hitchcock, Blaine & Huber
30 Rockefeller Plaza, Suite 3137
New York, NY 10112
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
Digital Equipment Corporation

:
:
: AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law :
for the Fiscal Years Ended 6/28/75, 7/3/76, 7/2/77, :
7/1/78. :

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 28th day of June, 1985, he served the within notice of Decision by certified mail upon Digital Equipment Corporation, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Digital Equipment Corporation
100 Nagog Park
Acton, MA 01720

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
28th day of June, 1985.

David Parchuck

James J. O'Connell
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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of
Digital Equipment Corporation :

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Edward M. Griffith
Phillips, Lytle, Hitchcock, Blaine & Huber
30 Rockefeller Plaza, Suite 3137
New York, NY 10112

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David Parchuck

James W. Richardson
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
DIGITAL EQUIPMENT CORPORATION	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Franchise Tax on Business Corporations	:	
under Article 9-A of the Tax Law for the Fiscal	:	
Years Ended June 28, 1975, July 3, 1976, July 2,	:	
1977 and July 1, 1978.	:	

Petitioner, Digital Equipment Corporation, 100 Nagog Park, Acton, Massachusetts 01720, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the fiscal years ended June 28, 1975, July 3, 1976, July 2, 1977 and July 1, 1978 (File No. 37266).

A formal hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 23, 1984 at 9:15 A.M., with all briefs to be submitted by November 27, 1984. Petitioner appeared by Phillips, Lytle, Hitchcock, Blaine & Huber, Esqs. (Edward M. Griffith, Jr., Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUES

I. Whether the inclusion by petitioner in a combined franchise tax report of six of its wholly-owned subsidiaries, including Digital Equipment Corporation de Puerto Rico, is required in order to properly reflect petitioner's franchise tax liability.

II. Whether petitioner is properly entitled to the DISC export credit provided by section 210.13 of the Tax Law.

FINDINGS OF FACT

1. On September 15, 1981, subsequent to the conduct of a field audit, the Audit Division issued to petitioner, Digital Equipment Corporation ("Digital"), four notices of deficiency, asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended June 28, 1975, July 3, 1976, July 2, 1977 and July 1, 1978 in the respective amounts of \$24,919.00, \$128,452.00, \$308,885.00 and \$286,824.00, plus interest. The corporation tax examiner recommended and the asserted deficiencies are premised on the following adjustments: (a) the inclusion by Digital in a combined franchise tax report of six of its wholly-owned subsidiaries, Digital Equipment Corporation de Puerto Rico ("DEC-PR"), Digital Equipment Corporation International ("DEC-International"), Digital Equipment Corporation Asia ("DEC-Asia"), Digital Equipment Corporation Latin America ("DEC-Latin America"), Digital Equipment Corporation Realty Trust ("DEC-Trust") and Digital International Sales Corporation ("Sales"); (b) the disallowance of the DISC export credit to petitioner on the ground that the credit only has application to export sales shipped from New York; (c) the recomputation of the property and receipts factors of the business allocation formula; and (d) the add-back of interest expense indirectly attributable to subsidiary capital. In computing the entire net income of the combined group, the Audit Division treated the research and development costs of both Digital and DEC-PR as expense items; for federal corporation income tax purposes, DEC-PR had elected to capitalize and amortize such costs.

Subsequent to the issuance of the notices of deficiency, Digital informed the Audit Division of certain changes to its federal corporation income tax returns for the fiscal years ended June 28, 1975, July 3, 1976 and July 2, 1977 made by the Internal Revenue Service. The Audit Division augmented

the combined group's entire net income to take account of the federal changes for such years, and by way of its answer to the perfected petition, asserted greater deficiencies for the fiscal years 1975, 1976 and 1977 in the amounts of \$53,084.00, \$190,303.00, and \$407,834.00, respectively.

2. Digital is presently the second largest computer company in the United States. It designs, manufactures and distributes computer equipment and systems throughout the world. It is headquartered in Massachusetts where it has manufacturing as well as support facilities. During the years in question, it also had manufacturing facilities in New Hampshire, New Mexico, Vermont and Arizona. For the period 1976 to 1978, the number of employees ranged from about 18,500 to 25,000. Digital's activities in New York State are limited to the sales and servicing of computer equipment through branch sales and service offices. It does no manufacturing in New York.

3.(a) DEC-International has a sales and service office and employees in Tokyo, Japan. It sells Digital products to the Far East market. It has no employees or operations in the United States.

(b) During the relevant period, DEC-Asia had a sales and service office and employees in Iran. It had no employees or operations in the United States.

(c) During the relevant period, DEC-Latin America had a sales and service office and employees in San Juan, Puerto Rico. It had no employees or operations in the United States.

(d) During the relevant period, DEC-Trust was a Massachusetts business trust that held real property which it leased to Digital. It had no office or employees in New York.

(e) During the relevant period, Sales was a Domestic International Sales Corporation for federal income tax purposes. All of the products relating

to the export sales made by it, and upon which it received commissions, were shipped from Maynard, Massachusetts.

4. DEC-PR is a Delaware corporation with its headquarters and manufacturing facilities in Puerto Rico. It has no employees, facilities or operations in New York State. During the years in question, DEC-PR had two manufacturing plants, one in San German and the other in Aquadilla, totalling about 500,000 square feet. Its employee population ranged from 2,000 to 3,000 and included direct labor operators, electronic and mechanical technicians, manufacturing engineers and professional managers. Of the total employee population, only about 50 employees were from the continental United States, the remainder being from Puerto Rico.

5. For fiscal years 1975 and 1976, DEC-PR was a qualifying corporation under section 931 of the Internal Revenue Code. Pursuant to that provision, its gross income for federal income tax purposes included only gross income from sources within the United States. Since all of its income from these years was from Puerto Rico, it had no gross income for federal income tax purposes.

By reason of a change by the Tax Reform Act of 1976, DEC-PR became subject to the provisions of section 936 of the Code for fiscal years 1977 and 1978. Section 936 provides a special tax credit to a qualifying corporation which is equal to the federal income tax attributable to the corporation's income from sources without the United States from the active conduct of a trade or business within a possession and from qualified possession source investment income.

6. DEC-PR manufactured computer subassemblies and finished options, including printed wiring boards, backplanes and central processing units. In

general, the operations were relatively highly automated, with assembly processes as well as quality and reliability testing being computer-directed.

For the most part, the products manufactured by DEC-PR were designed by Digital. DEC-PR received from its parent drawings, specifications and "tools" (hardware and software utilized to manufacture the product) and was charged a research and development fee, computed in accordance with a formula established by a costsharing agreement between Digital and various of its subsidiaries including DEC-PR.

DEC-PR employed an extensive labor force of technicians and engineers who were experts in product technology and process technology. Extensive knowledge of the products themselves ("product technology") was required to manufacture the products and to perform the testing and diagnostic routines. In addition, it was essential for DEC-PR to have technicians and engineers skilled in the manufacturing process itself ("process technology"). DEC-PR purchased approximately 19 percent of its supplies from Digital and the remainder of its raw materials from vendors in Puerto Rico, the United States, Europe and the Far East. Because in some instances the vendor base used by DEC-PR was different from that used by the Digital group in the United States, the DEC-PR process technicians and engineers tailored and accommodated the processes accordingly.

An integral part of the DEC-PR manufacturing operation was materials planning and management, the procurement of materials and the setting of manufacturing schedules, taking into consideration Digital's business requests, historical shipments of particular products, market projections and other factors. These schedules were in turn used to determine the kind and amount of materials to be procured, inventory levels and product mix.

Despite the fact that approximately 94 percent of its products were sold to Digital, customer service was an important consideration to DEC-PR, given that it competed with other plants and subsidiaries in the Digital group for the opportunity to manufacture the same products. Thus, DEC-PR's ability to be cost effective, to manufacture high quality products and to be responsive to customer demands tended to enhance its competitive edge.

7. DEC-PR had its own personnel department which was charged with the responsibilities of administering wage and benefit packages, the training and development of personnel, and recruitment.

Compensation paid to the DEC-PR employees was very competitive. Compensation packages were designed to be consistent with the general Digital policy of affording employees an attractive place to work but were also fashioned to be suitable to the particular environment. In at least one instance, the policy adopted by DEC-PR with respect to providing automobiles for certain executives was contrary to policy at the parent level.

Personnel training and development were provided by DEC-PR in-house or by professionally sponsored courses and schools on the Island or in the United States.

Personnel were exchanged between DEC-PR and Digital, but most often, employees were recruited from companies outside the Digital group. There existed no formal program in the group for the exchange of personnel between companies.

Finally, DEC-PR retained a San Juan law firm to handle all its labor related legal matters.

8. DEC-PR had its own finance department, encompassing the usual functions of budgeting, cost accounting and treasury. DEC-PR annually developed and

established cost goals and periodically reviewed compliance with its goals. Digital conducted a final review of DEC-PR's budget after its formulation by the subsidiary. DEC-PR retained an accounting firm located in San Juan which performed audits of the subsidiary's records and issued certified financial statements.

9. From time to time, it was necessary for the management of DEC-PR to meet with Puerto Rican government officials with respect to employee compensation packages, tax compliance and transportation and communication services. The management also frequently met with Fomento, the local industrial development agency, which considered DEC-PR a "model" operation to entice prospective new business to the Island.

10. An Internal Revenue Service team, consisting of auditors, international operations examiners, computer specialists and a case manager, conducted an examination of Digital's books and records for the fiscal years 1975 through 1978 with particular attention to the prices charged Digital by DEC-PR. In determining intercompany prices, Digital applied a profit-split method. On the theory that the group of corporations engaged in two profit-generating activities, manufacturing and sales, Digital set prices at a level so as to split overall group profit evenly between the manufacturing and sales operations.

In the course of the audit, the Service retained industrial economists who studied comparable companies and concluded that a cost-plus method was more appropriate (than the profit-split method) to measure the profit of DEC-PR. In arriving at a profit algorithm, the economists excluded research and development expenses and the costs of intercompany purchases from the definition of cost to be marked up, and accorded Digital one-half of the labor savings attributable to the Puerto Rican operations. The resultant markup and profit rate applied

was roughly 10 percent. The Service adopted the economists' conclusions in their entirety.

Digital took strong exception to the economists' report and the effects thereof on the proposed adjustments. Digital objected to the list of comparable companies, to the exclusion from the cost base of research and development expenditures and of intercompany materials purchases, and to the markup rate which it viewed as unreasonably low, constituting approximately one half of the overall consolidated profit rate of the Digital group.

Digital requested review of the proposed adjustments by the Service Appeals Division. Agreement was reached on the pricing adjustments for fiscal years 1975, 1976 and 1977. The profit algorithm was modified to include research and development expenses and one-half of the intercompany materials purchases in the cost base, and DEC-PR's profit was calculated at an amount approximately equal to the overall consolidated profit of Digital. The pricing adjustments which increased Digital's federal taxable income for the fiscal years 1975, 1976 and 1977 were \$3,726,000.00, \$6,767,000.00 and \$15,299,000.00, respectively. No agreement has yet been achieved regarding fiscal year 1978, but it is anticipated that the same formula adopted for the earlier fiscal years will be used.

11. The Audit Division maintains that the above-described federal adjustments did not result in true arm's length prices for sales of property from DEC-PR to Digital. To support its position, it relies upon a 1981 General Accounting Office report which found that only a small portion of adjustments made by the Service pursuant to Internal Revenue Code section 482 were based on true arm's length price.

CONCLUSIONS OF LAW

A. That section 211.4 of the Tax Law authorizes the Tax Commission, in its discretion, to require or permit a parent corporation and its wholly-owned subsidiaries to file a franchise tax report on a combined basis; a combined report embracing a corporation not a taxpayer (i.e., a foreign corporation not doing business in New York) cannot be required, however, unless the Commission deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in section 211.5, in order properly to reflect the tax liability under Article 9-A. Thus, in the case at hand, the question resolves itself to whether combined reports will fulfill the underlying statutory purpose of avoiding the distortion of and accurately portraying petitioner's true income. (See Matter of Coleco Industries, Inc. v. State Tax Comm., 92 A.D.2d 1008, affd. mem., 59 N.Y.2d 994; and 20 NYCRR 6-2.3, effective for all taxable years ending on or after December 31, 1983.)

B. That the record establishes that for the fiscal years in question, the Internal Revenue Service performed an audit of petitioner and its various subsidiaries and scrutinized the intercompany pricing with respect to sales of tangible personal property. As a result of the examination (and after administrative appellate procedures), the Service proposed substantial pricing adjustments and substantial increases to Digital's net income by virtue of the authority granted it by Internal Revenue Code section 482 to distribute, apportion or allocate gross income, deductions, credits or allowances among corporations if it is determined that such distribution, apportionment or allocation is necessary "in order to prevent evasion of taxes or clearly to reflect the income" of such corporations. Where sales of tangible personal

property occur among members of a controlled group of corporations, the regulations promulgated under Code section 482 permit the Service to "make appropriate allocations between the seller and the buyer to reflect an arm's length price" for the sales (Treas. Reg. §1.482-2[e][1][i]) and prescribe methods for determining an arm's length price as well as standards for the application of such methods (Treas. Reg. §1.482-2[e][2], [3] and [4]). Based on a study by economists, the Service employed the cost-plus method of regulation section 1.482-2(e)(4) to establish proper intercompany pricing to place this group of controlled taxpayers on a tax parity with similarly situated uncontrolled taxpayers. (See Treas. Reg. §1.482-1[b][1] which sets forth the scope and purpose of section 482.)

Unlike Matter of Standard Manufacturing Co., Inc. (State Tax Comm., May 2, 1984), where the taxpayer unsuccessfully asserted that section 482 adjustments assured arm's length prices between it and its Puerto Rican-based subsidiary for subsequent years not reviewed by the Service, Digital provided evidence of changes for the taxable years at issue. The Audit Division then made no showing that such changes did not result in arm's length prices.

Therefore, inasmuch as an extensive federal audit focused on the intercompany transactions between Digital and its subsidiaries, and petitioner reported the resultant changes to New York with their concomitant impact on entire net income, combined reports were not necessary in order to properly reflect Digital's franchise tax liability.

C. That in light of the action by the Court of Appeals in invalidating that portion of the DISC export credit which discriminated against exports shipped from outside New York and effectively extending the credit to all of a shareholder's DISC income which has a nexus to this state, petitioner is

properly entitled to the credit provided by Tax Law section 210.13 with respect to sales by its domestic international sales corporation (Matter of Westinghouse Electric Corp. v. Tully, 63 N.Y.2d 191).

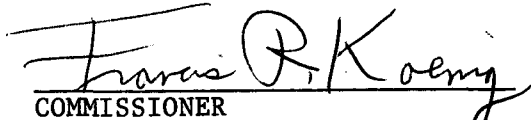
D. That the petition of Digital Equipment Corporation is granted to the extent indicated in Conclusions "B" and "C"; the notices of deficiency for the fiscal years ended June 28, 1975, July 3, 1976 and July 2, 1977 issued on September 15, 1981 and increased by the Audit Division in its answer are to be modified accordingly; the Notice of Deficiency for the fiscal year ended July 1, 1978 issued on September 15, 1981 and increased by the Audit Division's answer is sustained until petitioner reports to the Audit Division the federal changes to its return for such year, at which time the deficiency is to be modified in accordance herewith; and except as so granted, the petition is in all other respects denied.

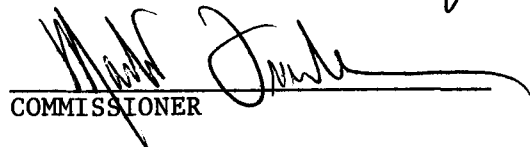
DATED: Albany, New York

JUN 28 1985

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER

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STATE OF NEW YORK

State Tax Commission

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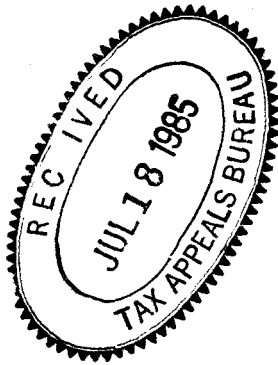
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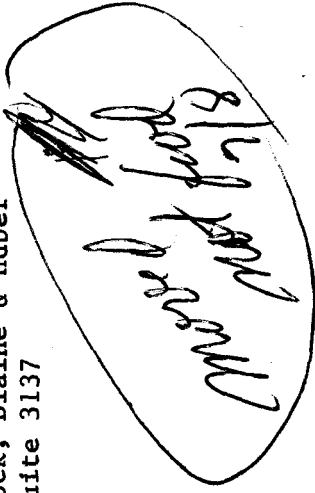
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Delivered
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Edward M. Griffith
Phillips, Lytle, Hitchcock, Blaine & Huber
30 Rockefeller Plaza, Suite 3137
New York, NY 10112



REQUEST FOR BETTER ADDRESS

Requested by Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Date of Request 7/18/85
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Please find most recent address of taxpayer described below; return to person named above.

Social Security Number	Date of Petition Jan. - Dec. - 6/28/85
Name Edward M. Griffith	
Address Phillips, Lytle, Hitchcock, Blaine, & Huber 30 Rockefeller Plaza, Suite 3137 New York, N. Y. 10112	

Results of search by Files

<input type="checkbox"/> New address:	no found RP 84-83-82 pd 7/19/85
<input type="checkbox"/> Same as above, no better address	
<input type="checkbox"/> Other:	Moved not forwardable

Searched by	Section	Date of Search

PERMANENT RECORDFOR INSERTION IN TAXPAYER'S FOLDER

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

June 28, 1985

Digital Equipment Corporation
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In the Matter of the Petition	:	
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DIGITAL EQUIPMENT CORPORATION	:	DECISION
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Years Ended June 28, 1975, July 3, 1976, July 2,	:	
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ISSUES

I. Whether the inclusion by petitioner in a combined franchise tax report of six of its wholly-owned subsidiaries, including Digital Equipment Corporation de Puerto Rico, is required in order to properly reflect petitioner's franchise tax liability.

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Finally, DEC-PR retained a San Juan law firm to handle all its labor related legal matters.

8. DEC-PR had its own finance department, encompassing the usual functions of budgeting, cost accounting and treasury. DEC-PR annually developed and

established cost goals and periodically reviewed compliance with its goals. Digital conducted a final review of DEC-PR's budget after its formulation by the subsidiary. DEC-PR retained an accounting firm located in San Juan which performed audits of the subsidiary's records and issued certified financial statements.

9. From time to time, it was necessary for the management of DEC-PR to meet with Puerto Rican government officials with respect to employee compensation packages, tax compliance and transportation and communication services. The management also frequently met with Fomento, the local industrial development agency, which considered DEC-PR a "model" operation to entice prospective new business to the Island.

10. An Internal Revenue Service team, consisting of auditors, international operations examiners, computer specialists and a case manager, conducted an examination of Digital's books and records for the fiscal years 1975 through 1978 with particular attention to the prices charged Digital by DEC-PR. In determining intercompany prices, Digital applied a profit-split method. On the theory that the group of corporations engaged in two profit-generating activities, manufacturing and sales, Digital set prices at a level so as to split overall group profit evenly between the manufacturing and sales operations.

In the course of the audit, the Service retained industrial economists who studied comparable companies and concluded that a cost-plus method was more appropriate (than the profit-split method) to measure the profit of DEC-PR. In arriving at a profit algorithm, the economists excluded research and development expenses and the costs of intercompany purchases from the definition of cost to be marked up, and accorded Digital one-half of the labor savings attributable to the Puerto Rican operations. The resultant markup and profit rate applied

was roughly 10 percent. The Service adopted the economists' conclusions in their entirety.

Digital took strong exception to the economists' report and the effects thereof on the proposed adjustments. Digital objected to the list of comparable companies, to the exclusion from the cost base of research and development expenditures and of intercompany materials purchases, and to the markup rate which it viewed as unreasonably low, constituting approximately one half of the overall consolidated profit rate of the Digital group.

Digital requested review of the proposed adjustments by the Service Appeals Division. Agreement was reached on the pricing adjustments for fiscal years 1975, 1976 and 1977. The profit algorithm was modified to include research and development expenses and one-half of the intercompany materials purchases in the cost base, and DEC-PR's profit was calculated at an amount approximately equal to the overall consolidated profit of Digital. The pricing adjustments which increased Digital's federal taxable income for the fiscal years 1975, 1976 and 1977 were \$3,726,000.00, \$6,767,000.00 and \$15,299,000.00, respectively. No agreement has yet been achieved regarding fiscal year 1978, but it is anticipated that the same formula adopted for the earlier fiscal years will be used.

11. The Audit Division maintains that the above-described federal adjustments did not result in true arm's length prices for sales of property from DEC-PR to Digital. To support its position, it relies upon a 1981 General Accounting Office report which found that only a small portion of adjustments made by the Service pursuant to Internal Revenue Code section 482 were based on true arm's length price.

CONCLUSIONS OF LAW

A. That section 211.4 of the Tax Law authorizes the Tax Commission, in its discretion, to require or permit a parent corporation and its wholly-owned subsidiaries to file a franchise tax report on a combined basis; a combined report embracing a corporation not a taxpayer (i.e., a foreign corporation not doing business in New York) cannot be required, however, unless the Commission deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in section 211.5, in order properly to reflect the tax liability under Article 9-A. Thus, in the case at hand, the question resolves itself to whether combined reports will fulfill the underlying statutory purpose of avoiding the distortion of and accurately portraying petitioner's true income. (See Matter of Coleco Industries, Inc. v. State Tax Comm., 92 A.D.2d 1008, affd. mem., 59 N.Y.2d 994; and 20 NYCRR 6-2.3, effective for all taxable years ending on or after December 31, 1983.)

B. That the record establishes that for the fiscal years in question, the Internal Revenue Service performed an audit of petitioner and its various subsidiaries and scrutinized the intercompany pricing with respect to sales of tangible personal property. As a result of the examination (and after administrative appellate procedures), the Service proposed substantial pricing adjustments and substantial increases to Digital's net income by virtue of the authority granted it by Internal Revenue Code section 482 to distribute, apportion or allocate gross income, deductions, credits or allowances among corporations if it is determined that such distribution, apportionment or allocation is necessary "in order to prevent evasion of taxes or clearly to reflect the income" of such corporations. Where sales of tangible personal

property occur among members of a controlled group of corporations, the regulations promulgated under Code section 482 permit the Service to "make appropriate allocations between the seller and the buyer to reflect an arm's length price" for the sales (Treas. Reg. §1.482-2[e][1][i]) and prescribe methods for determining an arm's length price as well as standards for the application of such methods (Treas. Reg. §1.482-2[e][2], [3] and [4]). Based on a study by economists, the Service employed the cost-plus method of regulation section 1.482-2(e)(4) to establish proper intercompany pricing to place this group of controlled taxpayers on a tax parity with similarly situated uncontrolled taxpayers. (See Treas. Reg. §1.482-1[b][1] which sets forth the scope and purpose of section 482.)

Unlike Matter of Standard Manufacturing Co., Inc. (State Tax Comm., May 2, 1984), where the taxpayer unsuccessfully asserted that section 482 adjustments assured arm's length prices between it and its Puerto Rican-based subsidiary for subsequent years not reviewed by the Service, Digital provided evidence of changes for the taxable years at issue. The Audit Division then made no showing that such changes did not result in arm's length prices.

Therefore, inasmuch as an extensive federal audit focused on the intercompany transactions between Digital and its subsidiaries, and petitioner reported the resultant changes to New York with their concomitant impact on entire net income, combined reports were not necessary in order to properly reflect Digital's franchise tax liability.

C. That in light of the action by the Court of Appeals in invalidating that portion of the DISC export credit which discriminated against exports shipped from outside New York and effectively extending the credit to all of a shareholder's DISC income which has a nexus to this state, petitioner is

properly entitled to the credit provided by Tax Law section 210.13 with respect to sales by its domestic international sales corporation (Matter of Westinghouse Electric Corp. v. Tully, 63 N.Y.2d 191).

D. That the petition of Digital Equipment Corporation is granted to the extent indicated in Conclusions "B" and "C"; the notices of deficiency for the fiscal years ended June 28, 1975, July 3, 1976 and July 2, 1977 issued on September 15, 1981 and increased by the Audit Division in its answer are to be modified accordingly; the Notice of Deficiency for the fiscal year ended July 1, 1978 issued on September 15, 1981 and increased by the Audit Division's answer is sustained until petitioner reports to the Audit Division the federal changes to its return for such year, at which time the deficiency is to be modified in accordance herewith; and except as so granted, the petition is in all other respects denied.


DATED: Albany, New York

STATE TAX COMMISSION

JUN 28 1985


PRESIDENT


COMMISSIONER


COMMISSIONER